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The Federal Farm Loan Bureau

Modern American Law Lecture



Blackstone Institute, Chicago

THE FEDERAL FARM LOAN BUREAU

BY

HERBERT QUICK

FORMER MEMBER FEDERAL FARM LOAN BUREAU

*One of a Series of Lectures Especially Prepared
for the Blackstone Institute*



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HERBERT QUICK

Mr. Quick was appointed a member of the Federal Farm Loan Bureau at the time of its creation, and served until he resigned on Aug. 1, 1919. He is by profession a lawyer, having prepared himself for the practice of law while principal of a ward school in Mason City, Iowa. He was admitted to the bar in 1889, and practised in Sioux City, Iowa, from 1890 until 1909. During this period he served one term as mayor of Sioux City and also became widely known as a publicist and writer on economic subjects.

In 1902 he published his first book, and since that time has added constantly to his list of published works. These books include several novels, a volume of short stories, a book on world problems—"On Board the Good Ship Earth"—and a work on transportation and conservation—"American Inland Waterways." The "Brown Mouse," published in 1915, while fictional in form, has attracted attention as a contribution to educational thought and to the solution of our problems of rural organization. For several years he was editor of one of the most influential farm journals in the United States, and in that capacity made careful studies of the various problems of rural life in America, and became recognized as an authoritative thinker on rural education as well as upon the general topic of rural credits.

During all of these years he was a voluminous writer of newspaper and magazine articles. He was one of the rural economists whose counsel was sought by Congress in framing the Federal Farm Loan Act, and his activities in this field lead to his appointment as one of the first members of the Bureau.

He is a member of The Cliff Dwellers, in Chicago, and of the Cosmos Club, in Washington.

THE FEDERAL FARM LOAN BUREAU

ITS ORIGIN, PLAN AND PURPOSE

By

HERBERT QUICK

DEFINITION AND LEGAL STATUS

The Federal Farm Loan Bureau is a bureau of the Treasury Department. It was created by the Federal Farm Loan Act which became a law on July 17, 1916, the third section of which contains these words: "There shall be established at the seat of government in the Department of the Treasury a bureau charged with the execution of this Act and of all Acts amendatory thereof, to be known as the Federal Farm Loan Bureau, under the general supervision of a Federal Farm Loan Board."

The Act declares itself to be "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgages, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositories and financial agents for the United States. and for other purposes."

ORIGIN AND HISTORY

The passage of the Act came at the end of a somewhat protracted period of preparation in the public mind and in Congress. For many years prior

to its enactment students of agricultural economics had recognized the fact that while the American banking system has been fairly adequate as a means of financing the other businesses of the nation, something different is required if the peculiar financial needs of the farmer are properly to be met. A growing knowledge of the somewhat protracted and quite successful experience which European countries have enjoyed in the establishment and maintenance of distinctly rural and agricultural financial systems reacted very strongly upon American public opinion while in this formative state.

Peculiar Needs of American Agriculture

American agriculture originally found itself and still to a large extent persists in an environment very different from that of European or Asiatic agriculture. Both labor and capital were originally scarce in America, and both interest and wages were high. Thus, two of the three basic factors of production, labor and capital, were difficult to obtain, whereas under European and Asiatic conditions both of these were plentiful, and even redundant. On the other hand land in America was plentiful and cheap, while under the conditions surrounding European and Asiatic agriculture it was scarce and high. Thus, in the division of produced wealth into the three economic funds, interest, wages and rent, the two former in America were of primary importance, while in Europe and Asia they were of secondary importance. On the other hand, the third factor, rent—by which is meant not only rent in the ordinary and popular

sense, but also rent in the economic sense, which includes the price to be paid for land—while of primary importance in Europe and Asia, was of secondary importance in the United States. Thus, it was not only natural but inevitable that in America agriculture land was and to a considerable extent still is used freely and extensively, and both labor and capital were and still are used sparingly. This sparing use of labor and capital was made possible, and was accentuated and continued, by the opening up of great areas of free or cheap prairie land and by the almost simultaneous invention of certain types of labor-saving agricultural machinery, which enabled the farmer by small investments of capital and labor to utilize extensive areas of very fertile land. The economic effect of this American agricultural development was of world-wide importance, and for many years it forced the virtual abandonment of great areas of land in the eastern part of the United States, caused a readjustment of land values between the older states and prairie states, and plunged the European farmer, through the competition of American agricultural products, into a period of gloom and adversity which had much to do with the development in Europe of the typically rural financial systems, which have been to some extent copied in the Federal Farm Loan Act.

Necessity for New System

The economic necessity for a separate system of finance for the agriculture of the United States is deduced from certain rather simple financial and

agricultural facts. A careful study of farm mortgage conditions in the United States, published in 1916,* indicates that the average rate on farm loans prior to the passage of the Federal Farm Loan Act was somewhat in excess of 8 per cent. per annum. This "rate" includes interest and also commissions and other fees paid to agents and brokers, but does not include such costs as the examination of title and the making of abstracts. The cost as given is a careful approximation and makes no claim to mathematical exactness. In different parts of the country the rate varies sharply from the norm. In New Mexico, for instance, the rate was on the average nearly 11 per cent.; in Florida, nearly 10 per cent.; in Montana, 10 per cent.; in Iowa about 6 per cent.; in New Hampshire, only a little in excess of 5 per cent. Even in the same state these rates differed greatly as to localities. In California, for instance, the rate varied from 6½ per cent. in one district to nearly 8 per cent. in another, and in Washington from 8 per cent. in one district to nearly 9 per cent. in another. In the main, the rate varied with the local supply of money for farm loan purposes, and not altogether according to the fundamental integrity of the security. The exemption of mortgages from taxation has in some places resulted in a lowering of the rate of interest. The lowest rate prevailing in any state was in New Hampshire under a law which provides that real estate mortgages shall be exempt from taxation in all cases

* Costs and Sources of Farm-Mortgage Loans in the United States. C. W. Thompson, United States Department of Agriculture, Bulletin 384.

in which the interest rate does not exceed 5 per cent. per annum. There is no agricultural or financial reason to believe that farm mortgages in New Hampshire are any safer investment than in Iowa or Illinois, or in many other states where the interest rate is higher than in New Hampshire. In fact, many mortgages in zones of higher interest rates remote from local supplies of loanable funds probably are safer when fundamental values are considered than are those in some zones of low interest rates. The cheapness of money on farm loans in New Hampshire is clearly the result of an adequate local supply of money in connection with exemption from taxation. Other factors which cannot be considered here have always entered into the interest rate and cost of farm loans.

The figures given do not adequately express the hardships under which vast numbers of farmers in the United States have suffered from excessive interest rates. A careful study of the situation at hearings held by the Federal Farm Loan Board lead to the conclusion that many of the most extreme cases of extortion escape the statistician, and are not found either in Dr. Thompson's bulletin or anywhere else in print. As in all cases of extortion through interest rates and commissions for loans, the burden has rested and still rests most heavily on those least able to bear it. It is true, however, that the figures given represent no doubt with an approximation to accuracy the burden borne by average agriculture in the United States and are, therefore, of controlling significance to the economist and student.

Changing Conditions Impose New Burdens

Under conditions of agriculture in which values are rapidly advancing and the soil is still in a state of virgin fertility, and while the loans are on the average small, a rate of 10 per cent., or even more, can no doubt be borne by agriculture. But as soon as land values become high and farm loans consequently large—in other words, when the element of land value becomes of prime importance—it is the opinion of agricultural economists, and this opinion is supported by farm experience, that a low interest rate becomes an absolute economic necessity, and that the interest rate which has prevailed over most of the United States becomes burdensome, if not actually ruinous. Let us take the case of a typical Iowa farmer, for instance. Fifty years ago, when the farm mortgage scarcely ever exceeded a debt of \$10 per acre, an interest charge of 10 per cent. imposed upon the farmer an annual charge of \$1 per acre. His crops at that time, while lower in market price than now, were actually redundant in yield. One and one-third bushels of wheat per acre at seventy-five cents per bushel, or five bushels of corn at twenty cents per bushel, would at that time pay his interest charge. A mortgage charge of \$50 per acre is now common in Iowa. Under normal conditions today the price of wheat does not rule over \$1 per bushel, or of corn more than forty cents, while the interest rate averages 6 per cent., imposing an interest charge of \$3 per acre. Under the lower rate of interest now prevailing, therefore, in terms of agricultural production the interest charge on an Iowa farmer is

three bushels of wheat per acre or seven and one-half bushels of corn. Analogous rates of increase in burden will be found to rule through the whole field of farm production, not only in Iowa but in every part of the United States in which agriculture has passed from the temporary extensive phase formerly mentioned to the more permanent and more intensive phase upon which it is now entering. The economic need for lower interest rates, therefore, is apparent, especially in view of the fact that the tendency of the mortgage burden is constantly to increase as agriculture becomes more highly developed.

Necessity for Long Term Loans

The development of agriculture, however, necessitates not only a lower rate of interest, but also different arrangements with reference to the time of payment. Under conditions prevailing in a new country the time element is not of controlling importance. Money on farm loans is under such conditions usually in demand for purposes which call for small investments and need have only short periods to run. It is obvious that the Iowa farmer of fifty years ago could even under conditions of pioneer hardships hope to pay off in five years a mortgage of \$10 per acre, absorbing as its interest rate only one-fifteenth of his agricultural production. Under present conditions his ability to pay off in five years a mortgage five times as large, absorbing one-tenth or more of the output of his farm, is obviously doubtful. It is in fact true that the average good farmer under present day conditions needs a long time loan, analogous in

its terms of payment to the long time bond issues of public utility and other corporations, if he is successfully to carry on the work of developing his farm.

Increasing Amounts of Capital Needed

Agriculture is changing from pioneer methods to those of a fully-settled continent. The virgin fertility of the soils is becoming depleted. An increasing urban population must now be fed, sheltered and clothed. The one-crop system, such as wheat after wheat, corn after corn, or cotton after cotton, is recognized as ruinous to the soil, to the farmer, and to the nation. But the grain farmer or the cotton farmer cannot change his methods without investing in live stock, machinery, buildings, fencing and reclamation, large sums, the returns from which, while sure, in case of wise investments, will on the average be slow. Out of these returns he must live, as well as pay interest and reduce principal. Dr. D. H. Otis, of the University of Wisconsin, finds from exhaustive researches that on dairy farms where the operating capital equals from 10 to 15 per cent. of the total value of the farm property the profits to the farmer are usually low, while farms with an operating capital of from 25 to 40 per cent. are usually more highly profitable. It is for the purpose of furnishing funds for changing from the unprofitable to the profitable condition that the Federal Farm Loan Act is on the statute books. The national problem justifying the legislation is to increase the volume of farm business per square mile, to generate a steadier and fuller supply of food and other farm

products, to bring into cultivation lands now uncultivated or only partially cultivated, and to prevent the destruction of the basis of the nation's life, the soil.

PROPOSED REMEDIES

A great many bills were introduced in both Houses of Congress to accomplish the objects of the Federal Farm Loan Act. These fall broadly into three classes: (1) Proposals for direct loans by the Federal Government to farmers, the funds to be provided by sales of Government bonds; (2) Schemes for the organization of land banks organized by lenders, having authority to provide themselves with funds by the sale of their own bonds; and (3) Systems under which the borrowers might organize coöperatively through land banks of their own under the general principles of the *Landschaft* banks of Germany. Bills of the second and third classes provided for Government inspection and regulation, and most bills of the third class for a greater or less degree of participation by the Government in the supplying of funds. No great support being developed in Congress for direct Government loans, the choice between the other two systems became the real issue, and the Federal Farm Loan Act as finally passed combined the two. It provides for a system of National Farm Loan Associations, which are coöperative associations of borrowers, and for Federal Joint Stock Land Banks, which are organizations of lenders.

JOINT STOCK LAND BANKS

The joint stock land bank feature of the law provides for the chartering by the Federal Farm Loan

Bureau of corporations for carrying on the business of lending money on farm mortgage security and issuing farm loan bonds. The provisions of the entire Act apply to them so far as they are applicable. They are under the control of the Federal Farm Loan Bureau. Their bonds must be physically readily distinguishable from the farm loan bonds issued by the Federal Land Banks described in the following pages. Their bonds and mortgages are exempt from taxation, and the lands on which their loans are placed must be appraised by appraisers appointed by the Bureau. They constitute a system of private institutions to make farm loans under public inspection and regulation.

THE CO-OPERATIVE SYSTEM

The establishment of any system of farm loan agencies under Government regulation and control is a distinctly new thing in this country, and the setting up of the Federal Joint Stock Land Bank system would in itself be an important financial innovation. The most important feature of the Federal Farm Loan Act, however, seems to be the coöperative farm loan system, which will now be described. The basic unit of this system is the coöperative organization of borrowers called the National Farm Loan Association. The nearest approach to the National Farm Loan system which we have heretofore had in America is the mutual building and loan association, which has for many years been a well known thing in city life. The building and loan association is an organization of borrowers whose savings are accu-

mulated through a system of monthly payments and the money thereby obtained loaned to the members of the association. These useful associations have familiarized the people of the United States with the two chief features of the National Farm Loan Association, to wit: the coöperative organization of borrowers, and the extinguishment of mortgage debts by a process of amortization.

A National Farm Loan Association may be formed anywhere in the United States by ten or more persons who at the time are, or are shortly to become, engaged in the cultivation of the farm mortgaged and whose contemplated loans amount in the aggregate to not less than \$20,000. Each of these prospective borrowers must be able to tender as security for his loan a first mortgage upon the land. The loan can not exceed in amount fifty per cent. of the value of the land, plus twenty per cent. of the value of the permanent, insured improvements. The association organizes by the execution of articles of association, specifying in general terms the object for which the association is formed and the territory in which its operations are to be carried on, signed by the persons uniting to form the association, and the sending of a copy thereof, together with its applications for loans and other documents provided for in the Act, to the Federal Land Bank of the district hereafter described. The association also elects a loan committee of three members, whose duties shall be to appraise and evaluate the lands offered as security for the mortgages, and the report of this loan committee on each loan must be unanimous. After having been dealt with accord-

ing to law by the Federal Land Bank of the district, the application of this association for a charter is forwarded to the Federal Farm Loan Board at Washington, and if the application is approved a charter is thereupon issued, whereupon the National Farm Loan Association becomes a body corporate chartered by the United States Government. As such a body corporate it has the power to endorse and become liable for the payment of mortgages taken from its shareholders, to receive from its land bank funds advanced under the law and to deliver the necessary receipts therefor, to acquire and dispose of such property as may be necessary or convenient for the transaction of its business, and to issue certificates of deposit for current funds, convertible into farm loan bonds at the land bank of the district in the amount of \$25 or any multiple thereof, but not to receive such deposits for any other purpose. The object of this latter provision is worthy of special notice. Such deposits can not be held by the association but must be sent immediately upon deposit to the land bank and invested in farm loan bonds. The evident intent of this provision is to encourage the habit of thrift and saving among farmers and their families and also to encourage the flotation of a part at least of the farm loan securities among the farmers themselves.

It will be noted that the articles of association must describe the territory in which the association expects to do business. This does not mean, however, that there can be only one association in the territory described. The boundaries of the associations' fields of operation may overlap so that different classes and

groups of farmers enjoy perfect freedom in organizing associations of such numbers and territorial size as may be most convenient to them.

The association is governed by a board of five or more directors elected by the stockholder-borrowers, but the actual clerical work is done by an officer called a secretary-treasurer, who has charge of the funds and records of the association and is charged with the duty of conducting its correspondence. He also must exercise observation over the investment of the funds borrowed, since the loans are made for definite purposes set forth in the applications for loans.

PURPOSES FOR WHICH LOANS MAY BE MADE

The declared purposes of the Act are "To provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes." The primary object, therefore, is to provide capital for agricultural development. Loans can not, therefore, be made to farmers under the Act except:

(a) To provide for the purchase of land for agricultural uses;

(b) To provide for the purchase of equipment, fertilizers and live stock necessary for the proper and reasonable operation of the mortgaged farm;

(c) To provide buildings and for the improvement of farm lands; and

(d) To liquidate preëxisting indebtedness, either on mortgage or certain other indebtedness.

The restriction as to the right to borrow for the discharge of preëxisting debt is interesting as illustrating the spirit of the Act. A farmer may borrow to pay off any debt which he may owe, no matter how contracted, if such debt was in existence at the time of the organization of the first National Farm Loan Association established in or for the county in which the land mortgaged is situated, or he may borrow to pay off such debts if subsequently incurred for purposes mentioned under (a), (b), (c) and (d) above.

The Act thus provides a universal means for the extinguishment and funding of all debts no matter how unwisely or improvidently incurred prior to the establishment of the system in actual operation in the county in which the land is situated. After such establishment, however, a new era begins and the Federal Farm Loan system will not help out of his difficulties any agricultural debtor whose liabilities have been incurred for reasons which are regarded as unfarmerlike. The terms "equipment" and "improvement" in the Act are to be defined for borrowing purposes by the Federal Farm Loan Board.

INTEREST AND TERMS OF PAYMENT

The law fixes six per cent. per annum as the maximum rate which can be charged on farm loans under this system. The minimum rate, however, may fall considerably lower than this. As will be explained hereafter, the money for loaning is obtained chiefly, as heretofore, from investors. In this system it is

obtained through the sale by Federal land banks of securities known as Federal farm loan bonds. These bonds will be hereafter described. They will be offered in such a manner as to merit the confidence of investors, and it is anticipated that they will sell at an interest rate so low that after the entire expense of marketing them and of producing the mortgages is defrayed, the farmer borrowers will enjoy an interest rate of five per cent., or under. European land bonds issued under systems somewhat analogous have in the past sold at interest rates averaging as low, or almost as low, as the interest rate on the bonds of such governments as Germany and France.

The rate of interest, however, is of importance secondary perhaps to the matter of terms of payment. The private investor in farm mortgages has always been obliged to insist upon payment or renewal of the loan within a period of from one to ten years, and in the vast majority of cases mortgages have run from three to five years only. As heretofore stated, these periods are too short to be met by the slow development of agriculture. The Federal Farm Loan Act, therefore, provides that every mortgage shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual or semiannual installments sufficient to cover, first, the interest on the mortgage and second, such amounts to be applied on the principal as will extinguish the debt within an agreed period not less than five years nor more than forty years. This does not give the borrower the right of payment on the principal except after the

lapse of five years, and he may take the loan for a period of forty years if he desires. Under this plan if the interest rate is five per cent. and the amortization charge one per cent., the loan will be completely extinguished in about thirty-six years. The borrower is given great freedom in the matter of payments after the lapse of five years, since he is permitted at any interest date to pay off the principal in whole or in part, and payments as small in amount as \$25 will be accepted on the principal. Under this system, therefore, the borrower has complete control over his terms of payment, subject to the annual charges. In the past the lender has had the right to call the loan when due. Under the Federal Farm Loan system this option is transferred to the borrower and all anxiety and uncertainty with reference to the maturity of the loan is at an end.

In the past in many parts of the United States while the farmer carrying on operations in a large way or possessing land of a considerable value has been able to secure loans with ease, the needs of the small farmer have not been so adequately met. His transaction has not been of value to loaning institutions. It has been quite as expensive to the investor to make a loan of \$500 as one of \$5000. Therefore, the rate to the small farmer, when commissions and brokerage are considered, has been unduly high, and in many parts of the country he has been unable to secure money at all. Under the Federal Farm Loan system loans may be made for as small an amount as \$100. The provision for the borrowing of money for the purchase of agricultural

land might lend itself to the purchase of land for speculative purposes were it not for the fact that the law limits the aggregate loans to any one individual under the law to \$10,000.

WHO MAY NOT BORROW

As stated above, the law presupposes that the borrower is, or is about to become engaged, in the cultivation of the land mortgaged. This does not necessarily mean that he must be cultivating it with his own hands. The farmer who is incapacitated by illness or otherwise may cultivate the lands by hired labor. There are village communities in Utah made up of farmers who live in the villages and go out to their farms to cultivate them. These may borrow although they do not live upon the lands. There are communities in other parts of the country in which the people live at some distance from their lands because of the insalubrious character of the climate of the farms themselves. These also may borrow although they do not live upon the land. Farmers who live in towns and carry on their farms by their own or hired labor, or both, may borrow under the Act. In short, anyone who cultivates the land mortgaged either by his own or hired labor may borrow, but the lands must be farms and not waste or unimproved lands, and if the owner lets them out on rent under any system, he is thereby rendered ineligible as a borrower. Such financial pressure as the system possesses is, therefore, constantly exerted in the direction not only of better farming but in favor of the actual

cultivator of the soil as distinguished from the landlord.

GOVERNMENT REGULATION AND APPRAISEMENT

The National Farm Loan Associations are chartered by the United States Government through the Federal Farm Loan Bureau and their affairs are under the supervision and examination of the Government in a manner analogous to the control over national banks. Moreover, the Government does not leave to the loan committees of the farm loan associations the entire matter of appraisement and valuation of lands. After the applications from a farm loan association have gone to the land bank, the Federal Farm Loan Bureau causes an appraisement of the lands to be made by appraisers appointed by the Federal Farm Loan Board, and no loans are made to farmers unless approved by these appraisers.

INVESTMENT AND LIABILITIES OF BORROWERS

The borrower is of course liable upon his mortgage to the Federal land bank, to which it is given for his loan. For reasons connected with the safety of the system and its extension he is obliged to assume certain other direct liabilities as well as a contingent one. When he joins a National Farm Loan Association he is required to become not only a member of it, but an investor in it. The National Farm Loan Association is a corporation owned by its stockholders, and its stockholders are borrowers only. Each borrower is required to purchase stock in his local association to the amount of five per cent. of his

loan. All funds so received by the National Farm Loan Association are at once used in purchasing stock in the Federal land bank of the district. Thus, the borrower is a stockholder in his association and the association is a stockholder in the Federal land bank. Each association becomes a guarantor of the payment, both as to principal and interest, of the loans made to its members. This guaranty, of course, can be enforced only to the extent of the assets of the association, and these assets consist mainly of its stock in the Federal land bank. While he remains a borrower the member of a National Farm Loan Association continues to hold his stock in the association, and when he pays off his loan the stock is retired at par and the borrower's money returned to him. Should any member of the association, however, receive a loan made unwisely or improvidently whereby it should suffer losses, this stock might be absorbed in making good such losses and the borrower would, therefore, lose this investment. Thus, the borrowers' investments in stock of their association constitute a guaranty fund of one-twentieth the amount of the loans. This adds to the caution and conservation of the loan committees and provides a guaranty fund against bad loans. In addition to this the stockholders in National Farm Loan Associations have the same double liability on the stock held by them which prevails as against stockholders in national banks. The direct and contingent liabilities, therefore, of the borrowers and the Federal Farm Loan system amount to ten per cent. of the face of the loans.

THE FEDERAL LAND BANK SYSTEM

Several references have been made to Federal land banks. These banks constitute the agencies by which money is obtained from investors and loaned. They are twelve in number and cover in their operations the entire continental United States, exclusive of Alaska. Their locations and territories are as follows:

The Springfield, Massachusetts, bank, District No. 1, has jurisdiction over the New England states, New York, and New Jersey;

The Baltimore, Maryland, bank, District No. 2, has jurisdiction over Pennsylvania, Delaware, Maryland, West Virginia, Virginia and the District of Columbia;

The Columbia, South Carolina, bank, District No. 3, has jurisdiction over the Carolinas, Georgia and Florida;

The Louisville, Kentucky, bank, District No. 4, has jurisdiction over Ohio, Indiana, Kentucky and Tennessee;

The New Orleans, Louisiana, bank, District No. 5, has jurisdiction over Alabama, Mississippi and Louisiana;

The St. Louis, Missouri, bank, District No. 6, has jurisdiction over Illinois, Missouri and Arkansas;

The St. Paul, Minnesota, bank, District No. 7, has jurisdiction over Michigan, Wisconsin, Minnesota and North Dakota;

The Omaha, Nebraska, bank, District No. 8, has jurisdiction over Iowa, South Dakota, Nebraska and Wyoming;

The Wichita, Kansas, bank, District No. 9, has jurisdiction over Kansas, Oklahoma, Colorado and New Mexico;

The Houston, Texas, bank, District No. 10, has jurisdiction over Texas;

The Berkeley, California, bank, District No. 11, has jurisdiction over California, Nevada, Utah and Arizona;

The Spokane, Washington, bank, District No. 12, has jurisdiction over Washington, Oregon, Idaho and Montana.

The law provides for a temporary board of directors consisting of a president, a vice president, a treasurer and a secretary, all of whom are directors, and an additional director, making a board of five appointed by the Federal Farm Loan Board. The permanent organization takes place in any bank whenever the subscriptions to stock in the Federal land bank by National Farm Loan Associations shall have reached the sum of \$100,000. This organization is effected by the election of six local directors by the National Farm Loan Associations of the district and the appointment of three district directors by the Federal Farm Loan Board. Thereafter, the affairs of the Federal land bank will be conducted by this permanent organization. The Act thus becomes even as to the organization of the land bank's cooperative system of borrowers.

The Sources of Funds

The land banks when organized have an initial supply of money furnished in the main by the 'Trea-

surety of the United States. This initial capital furnished in part by the Government and to a very limited extent by private investors amounts to \$750,000 for each bank, or \$9,000,000 in all. This sum, however, is only a supply of ready cash for the beginning of business. The regular supply of money must be obtained from investors. This is done in the following manner: When any bank has accepted mortgages to the amount of \$50,000 or more, it may apply through a resident officer of the Farm Loan Bureau known as the registrar for authority to issue Federal Farm Loan bonds. Permission to issue these bonds must be given by the Federal Farm Loan Board. The rate of interest payable on these bonds is the lowest which can be obtained in the money market at the time of their issue. In order that these bonds may be attractive to investors they are issued in denominations of \$25, \$50, \$100, \$500 and \$1000, are prepared by the Bureau of Engraving and Printing in Washington, are protected by the criminal law against counterfeiting, are made the joint and several liability of all the land banks, and are declared by the Act to be instrumentalities of the Government and exempt from all forms of taxation, State and Federal. They are secured, as has been stated, by farm mortgages placed on a conservative valuation under an appraisal, first by the farmers themselves and second by a Government appraiser, are further secured by the stock investments of the borrowers in the system and by the double liability on the stock in the National Farm Loan Associations.

Any lowering in the rate of interest attributable

to this attractive form of investment will inure to the benefit of borrowers under the system by reason of the fact that the rate paid by a borrower is made up by adding together the interest rate on Federal farm loan bonds and the expenses of operation of the Federal land bank. Thus, if the rate on Federal farm loan bonds is five per cent. per annum and the Federal land bank of the district requires one per cent. per annum to pay its cost of operation, the rate to the farmer will be six per cent., which is the maximum rate under the system. If, on the other hand, the time should come when Federal farm loan bonds sell at a price yielding an interest rate of three and one-half per cent., the farmers in any district in which the Federal land bank is able to do business on a basis of one-eighth of one per cent. will be able to borrow money at three and five-eighths per cent. per annum. The maximum amount which the Federal land bank can charge for cost of operation is one per cent. per annum.

CAPACITY FOR BUSINESS EXPANSION

The Federal Farm Loan system has the capacity to expand to an extent which will make it capable of doing any possible volume of business. The Federal land banks are permitted by law to issue bonds to the extent of twenty times their capital stock. The original stock being nine million dollars for the twelve banks, a business is at once authorized of one hundred and eighty million dollars in loans. It will be remembered, however, that each borrower by the investment of five per cent. of his loan in the stock of

his association enables his association to purchase an equal amount of stock in his district Federal land bank. Every loan made, therefore, expands the stock of the Federal land bank of the district to a point which will enable it to make an additional loan of the same amount. Thus, the authority to do business automatically expands to an extent commensurate with the growth of the business. The original stock of the land bank, whether taken by the government or by private subscriptions, will ultimately be retired under a provision which requires each Federal land bank, after subscriptions to its capital stock by National Farm Loan Associations shall amount to \$750,000, to apply semi-annually to the retirement of these original shares of stock twenty-five per cent. of all sums thereafter subscribed until all such original capital stock is retired at par. This retirement, however, does not operate to prevent the indefinite extension of the operations of the banks as above described.

CONSTITUTIONALITY OF LAW

The Federal Farm Loan Act covers a very complex and extensive field of human endeavor and will as the years pass undoubtedly become the basis of an important title of the law. No question has arisen as to its constitutionality except as to Section 26, which, after exempting from all taxation every Federal land bank and every National Farm Loan Association, including the capital and reserve or surplus therein or income derived therefrom, except taxes on real estate, provides as follows:

First mortgages executed to Federal Land Banks, or to Joint Stock Land Banks, and farm loan bonds issued under the provisions of this act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.

Certain criticisms have been directed against the constitutionality of this section of the Act and for the purpose of meeting these the Secretary of the Treasury some time in January, 1917, requested of the Attorney General an opinion on the matter. The Attorney General on January 30th rendered an opinion, the concluding paragraphs of which are as follows:

A tax upon these bonds and mortgages would, therefore, be a tax upon the most important operations of the system, and might hamper it to so great an extent as to render it unsuccessful. In other words, it might be found impossible to raise capital by means of the bonds, and it might be found impossible to loan money on the mortgages at the reasonable rate of interest desired, if these two fundamental instrumentalities were taxed by the States. At any rate, Congress might well think so, and its declaration upon the subject is conclusive.

I have the honor to advise you, therefore, that, in my opinion, that portion of Section 26 exempting the mortgages and bonds from State, municipal, and local taxation is constitutional.

In arriving at this opinion the Attorney General considered and cited *McCulloch v. the State of Maryland*, 4 Wheat. 316, and certain cases following, and similar to, that case, and also the following: *Weston v. the City of Charleston*, 2 Peters 449; *Bank v. Supervisors*, 7 Wall. 26; *Talbott v. The Silver Bow County*, 139 U. S. 438, 440; *People v. Weaver*, 100 U. S. 539, 543; *Farmers Bank v. Minnesota*, 232 U. S.

516; Choctaw and Gulf Railroad v. Harrison, 235 U. S. 292; and Indian Oil Co. v. Oklahoma, 240 U. S. 522, 529. These cases would seem to be conclusive as to the constitutionality of this feature of the Act.

FEDERAL FARM LOAN BOARD

The correlating, managing, examining and governing body of the Federal Farm Loan system is the Federal Farm Loan Board at Washington. This Board consists of the Secretary of the Treasury, ex officio a member of the Board and its chairman, and four members appointed by the President, one of whom is designated by the President as Farm Loan Commissioner and is the executive head of the Board charged with certain special official duties. The four appointed members of the Board were originally appointed for terms of office of two, four, six and eight years respectively, but at the expiration of each of the shorter terms the new appointments are for eight years. This Board controls the system through a bureau at Washington. It appoints the temporary boards of directors of the twelve land banks, the local directors in the permanent organizations, the twelve registrars, all the appraisers, and such other officers, agents, and experts as may be required for the system. It is empowered to print and distribute matters relating to publicity for the system. It charters Federal land banks, Federal joint stock land banks and National Farm Loan Associations, and has general powers of supervision, regulation and examination. One of the most significant things perhaps in the system is that a bureau is established in Washington

having the duty and the power constantly to study and examine the whole question of financing the farmers of the United States on land mortgage.

PERSONAL CREDIT FOR FARMERS

The Federal Farm Loan system is a land mortgage system pure and simple. It is a well recognized economic fact that farmers have personal credit needs and needs for short time accommodations on farm mortgage which are peculiar to themselves. These needs are not met and are not intended to be met by the Federal Farm Loan system. The Federal Reserve Act, however, has so changed the law with relation to national banks that the amount of land mortgage credit which can legally be extended by them to farmers is greatly increased. The Federal Farm Loan system does not loan money on farm mortgage for a term less than five years. The Federal Reserve Act, however, gives the national banks of the country legal authority to meet this short time farm mortgage need, and of course the field for making such loans is still open to trust companies, savings banks, private capitalists, insurance companies, and all other accumulations of loanable capital.

Unquestionably there is a need in every state in the Union for better agencies for the loaning of money on personal credit in small or large sums and on short time to farmers. The Federal Reserve Act has in part met this need by making the commercial paper of farmers eligible for rediscount in the Federal reserve banks when given for periods of time longer than that accorded to ordinary commercial

paper, and the obligations of farmers secured on properly margined warehouse receipts have been made eligible to a lower discount rate in the Federal reserve banks than that accorded to other paper. These measures, however, while important, do not afford complete relief. The National Government has as yet left to the states and to private capital the field of meeting these peculiar needs of the farmer. Bills have been introduced, however, in Congress for a personal rural credits system and the matter is still open to Congressional action.

There is another great field open to state and national legislation and that is the furnishing of credit for the purchase of land and equipment to tenant farmers and farm laborers who have not the means with which to purchase land and establish themselves as farmers. This object can not be accomplished on strictly farm mortgage principles and involves the advancement of funds and the acquisition of lands under a degree of personal and financial tutelage, which is not required where farm property of recognized value maybe tendered as security for mortgages. The matter is of great sociological importance, however, and in some states is being taken up and pressed vigorously. The second mortgage under the long time amortized Federal farm loan becomes a much better security than one made subject to a short time mortgage and there is considerable interest in many parts of the country in the establishment of agencies either private or governmental for handling such second mortgages, and thus enabling tenant farmers and others who can not pay fifty per cent. of the value

of their lands to be financed into actual, independent farm ownership. The development of these movements promises to be one of the most interesting things in the future of American agriculture.

CONCLUSION

We have here, therefore, a very important new development in American life: first, an important governmental bureau having control over the land mortgage business of such farmers as choose to enroll themselves in it; second, twelve great loan companies under coöperative management for the purpose of assembling the available money of the United States for investment in farm mortgage securities and for tendering to the investors of the United States, large and small, a security based upon farm mortgages which are themselves held, conserved and controlled by government officers appointed for that purpose; and third, an extensive system or coöperative organizations of farmers whose primary business is to control as borrowers the conditions under which they borrow, but whose secondary preoccupation will be so to conduct their farming operations as to make them the basis of safe investment. This of course means better agriculture.

Sociologically it may be expected that the organization of farmers into coöperative associations of borrowers will stimulate an interest in coöperation along other lines, thus accomplishing a result which is almost universally admitted to be desirable. The interest rates in all parts of the country are almost sure to be equalized, as the fundamental security

back of all the bonds offered is the same. The fact that in every part of the United States land values will be officially appraised and such appraisements made public will no doubt tend greatly to the stabilization of land values on farms and should prevent the development of booms based on fictitious and illusory conceptions of the profits to be made in colonization schemes and other land promotions. The system will doubtless result in some increase in land values, but this increase may be expected to be stable rather than speculative, since the financial pressure of the system is exerted in the direction not of speculation in farm lands or the holding of them out of use for monopolistic increments in value but in favor of the actual cultivator of the soil. The object for which the Act has been passed is a great one and is strictly in harmony with the very best thought not only in this country but in the world at large. The interest already shown by farmers and investors all over the United States seems to prove that the success of the system is not open to question.

Herbert Luick

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